MONETARY POLICY STATEMENT

PRESS CONFERENCE

Christine Lagarde, President of the ECB, Luis de Guindos, Vice-President of the ECB

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Jump to the transcript of the questions and answers

Good afternoon, the Vice-President and I welcome you to our press conference.

The euro area economy is continuing to recover and the labour market is improving further, helped by ample policy support. But growth is likely to remain subdued in the first quarter, as the current pandemic wave is still weighing on economic activity. Shortages of materials, equipment and labour continue to hold back output in some industries. High energy costs are hurting incomes and are likely to dampen spending. However, the economy is affected less and less by each wave of the pandemic and the factors restraining production and consumption should gradually ease, allowing the economy to pick up again strongly in the course of the year.

Inflation has risen sharply in recent months and it has further surprised to the upside in January. This is primarily driven by higher energy costs that are pushing up prices across many sectors, as well as higher food prices. Inflation is likely to remain elevated for longer than previously expected, but to decline in the course of this year.

The Governing Council therefore confirmed the decisions taken at its monetary policy meeting last December, as detailed in the press release published at 13:45 today. Accordingly, we will continue reducing the pace of our asset purchases step by step over the coming quarters, and will end net purchases under the pandemic emergency purchase programme (PEPP) at the end of March. In view of the current uncertainty, we need more than ever to maintain flexibility and optionality in the conduct of monetary policy. The Governing Council stands ready to adjust all of its instruments, as appropriate, to ensure that inflation stabilises at its two per cent target over the medium term.

I will now outline in more detail how we see the economy and inflation developing, and will then talk about our assessment of financial and monetary conditions.

Economic activity

Economic growth weakened to 0.3 per cent in the final quarter of last year. Nevertheless, output reached its pre-pandemic level at the end of 2021. Economic activity and demand will likely remain muted in the early part of this year for several reasons. First, containment measures are affecting consumer services, especially travel, tourism, hospitality and entertainment. Although infection rates are still very high, the impact of the pandemic on economic life is now proving less damaging. Second, high energy costs are reducing the purchasing power of households and the earnings of businesses, which constrains consumption and investment. And third, shortages of equipment, materials and labour in some sectors continue to hamper the production of manufactured goods, delay construction and hold back the recovery in parts of the services sector. There are signs that these bottlenecks may be starting to ease, but they will still persist for some time.

Looking beyond the near term, growth should rebound strongly over the course of 2022, driven by robust domestic demand. As the labour market is improving further, with more people having jobs and fewer in job retention schemes, households should enjoy higher income and spend more. The global recovery and the ongoing fiscal and monetary policy support also contribute to this positive outlook. Targeted and productivity-enhancing fiscal measures and structural reforms, attuned to the conditions in different euro area countries, remain key to complement our monetary policy effectively.

Inflation

Inflation increased to 5.1 per cent in January, from 5.0 per cent in December 2021. It is likely to remain high in the near term. Energy prices continue to be the main reason for the elevated rate of inflation. Their direct impact accounted for over half of headline inflation in January and energy costs are also pushing up prices across many sectors. Food prices have also increased, owing to seasonal factors, elevated transportation costs and the higher price of fertilisers. In addition, price rises have become more widespread, with the prices of a large number of goods and services having increased markedly. Most measures of underlying inflation have risen over recent months, although the role of temporary pandemic factors means that the persistence of these increases remains uncertain. Market-based indicators suggest a moderation in energy price dynamics in the course of 2022 and price pressures stemming from global supply bottlenecks should also subside.

Labour market conditions are improving further, although wage growth remains muted overall. Over time, the return of the economy to full capacity should support faster growth in wages. Market-based measures of longer-term inflation expectations have remained broadly stable at rates just below two per cent since our last monetary policy meeting. The latest survey-based measures stand at around two per cent. These factors will also contribute further to underlying inflation and will help headline inflation to settle durably at our two per cent target.

Risk assessment

We continue to see the risks to the economic outlook as broadly balanced over the medium term. The economy could perform more strongly than expected if households become more confident and save less than expected. By contrast, although uncertainties related to the pandemic have abated somewhat, geopolitical tensions have increased. Furthermore, persistently high costs of energy could exert a stronger than expected drag on consumption and investment. The pace at which supply bottlenecks are resolved is a further risk to the outlook for growth and inflation. Compared with our expectations in December, risks to the inflation outlook are tilted to the upside, particularly in the near term. If price pressures feed through into higher than anticipated wage rises or the economy returns more quickly to full capacity, inflation could turn out to be higher.

Financial and monetary conditions

Market interest rates have increased since our December meeting. However, bank funding costs have so far remained contained. Bank lending rates for firms and households continue to stand at historically low levels and financing conditions for the economy remain favourable. Lending to firms has picked up, supported by both short and longer-term loans. Robust demand for mortgages is sustaining lending to households. Banks are now as profitable as they were before the pandemic and their balance sheets remain solid.

According to our latest Bank Lending Survey, loan demand by firms increased strongly in the last quarter of 2021. This was driven by both higher working capital needs, stemming from supply bottlenecks, and increased financing of longer-term investment. In addition, banks continue to hold an overall benign view of credit risks, mainly because of their positive assessment of the economic outlook.

Conclusion

Summing up, the euro area economy continues to recover, but growth is expected to remain subdued in the first quarter. While the outlook for inflation is uncertain, inflation is likely to remain elevated for longer than previously expected, but to decline in the course of this year. We will remain attentive to the incoming data and carefully assess the implications for the medium-term inflation outlook. We stand ready to adjust all of our instruments, as appropriate, to ensure that inflation stabilises at its two per cent target over the medium term.

We are now ready to take your questions.

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My first one would be: In light of that record inflation reading seen in January for the eurozone, how did the discussion go in the Governing Council? Are there more frictions now, and is the camp of those who are calling for action getting louder?

The second one is on the market pricing in two rate hikes for 2022. You have been saying that a rate hike this year is highly unlikely. What are you saying now? Are you sticking to "highly unlikely," or have you moved on?

Thank you very much for these two very pertinent questions. Concerning inflation: with the upside surprise that we have seen first in December, second in January, I can tell you that there was unanimous concern around the table of the Governing Council about inflation numbers and obviously the impact this has on the near term and the impact this has on our compatriots in Europe. We know that the burden is first and foremost borne by those who are most vulnerable, most exposed and who face the day-to-day hardship of having to put up with higher prices. I can assure you that that concern was across the board and around the table in equal numbers.

We had a very thorough and in-depth discussion about inflation precisely and were focussing on the latest information we have, but also the impact that it will have on our medium-term outlook. That is clearly something that will be examined in more depth at the time of our March Governing Council meeting, when we produce more projections – which we have not on this occasion – when we can harness all the latest data that we have, where we can also have more information about the job markets, about wages and where we can really analyse in depth what the impact is on our medium-term projections. We are all driven by the same mandate, which is price stability. We are all concerned to take the right steps at the right time, and I think there was also a concern and a determination around the table not to rush into a decision unless we had a proper and thorough assessment based on data and the analytical work that will take place in the next few weeks. That's on your first point concerning the inflation numbers.

On the other question of the rate hikes: you know, I never make pledges without conditionalities and it is even more important at the moment to be very attentive to that. As I said, we will assess very carefully, we will be data dependent, we will do that work in March. I think it will take us into the analysis of what are the drivers behind inflation in the short term, what are the drivers behind inflation in the medium term, and how the whole outlook and medium-term projections look like. Let's not forget that we will continue doing so on the basis of our forward guidance, that we will continue to observe the sequence that we have agreed, and that we will be gradual in any determination that we make at the right time on the basis of data.

A couple of hours ago, President Lagarde, the Bank of England increased its rate by 0.25%. Four of the nine members of the Committee actually wanted more than that, they wanted 0.5%. You're going to tell me of course that different economies mean different decisions. Could you tell me: what is the difference between the 5.4% inflation in the UK compared to the 5.1% in the eurozone? Why is it not the same course of action in the ECB?

The other question is about wage growth. What can you tell us about wage growth in the eurozone? Do you see any sign of that? Are you worried about that side of things?

It's interesting because your second question is almost the answer to your first question, but I'll go back a little bit into history. The United Kingdom has had a history of much higher inflation than what we have had in the euro area; that's point number one. The critical difference now between our respective economies, the critical one – there are many other ones – but the critical one has to do with the labour market, where clearly there is a lot of pressure on wages, where there is scarcity of workers for jobs that are available, and where - I don't want to take a political stance, but I think that there was a lot of non-UK labour force that eventually had to leave the United Kingdom which has not been totally replaced, and where the shortage of workers is actually having a bearing on the forces of the labour market in the UK. So that's really in essence what is causing the significant difference between the two.

On the wage front: what we are seeing and that we can really celebrate is that the euro area is at the lowest unemployment number it has ever been. 7% unemployment is a record number. The second aspect of that labour market is that our participation of employees in the labour market is back to the level where it was pre-COVID. So on those two accounts we have good news to celebrate. What we are not yet seeing is a significant movement in terms of wage increases. We are not seeing a lot either in relation to wage negotiations. That normally should be the next step that we see, with lower unemployment, more people leaving the furlough schemes under which they were operating, and the output gap closing gradually and the economy returning to full capacity. We should see movement, and we are not seeing a lot of it yet. Now, of course a lot of the information that we are getting statistically is backward-looking, but we are also very attentive to what is happening and what is likely to happen.

That is actually taken into account to a certain extent in our projection numbers, but clearly what will happen in the next few weeks and what we can see, both for our March meeting and then later on our